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No. 05-1361

In the Supreme Court of the United States

EDUCATIONAL CREDIT MANAGEMENT CORPORATION,
PETITIONER

v.

LAURA SUSAN REYNOLDS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether a student-loan debtor's emotional stress at having to repay her student loans may constitute "undue hardship" permitting her a discharge under 11 U.S.C. 523(a)(8).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-27a) is reported at 425 F.3d 526. The opinion of the district court (Pet. App. 28a-40a) is unreported. The opinion of the bankruptcy court (Pet. App. 41a-78a) is reported at 303 B.R. 823.

JURISDICTION

The judgment of the court of appeals was entered on October 10, 2005. A petition for rehearing was denied on January 26, 2006. Pet. App. 79a-80a. The petition for a writ of certiorari was filed on April 24, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Section 523(a)(8) of the Bankruptcy Code provides that a student-loan debt is not dischargeable "unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. 523(a)(8). Although the Bankruptcy Code does not define the term "undue hardship," Congress has repeatedly limited the ability of debtors to discharge their student-loan debt. In 1976, Congress added a provision to the Higher Education Act of 1965, 20 U.S.C. 1001 *et seq.*, that barred the discharge of certain educational loans unless either (a) they had been in repayment for over five years or, if not, (b) payment would impose an undue hardship on the debtor or his dependents. Education Amendments of 1976, Pub. L. No. 94-482, § 127(a), 90 Stat. 2141. Since then, "Congress has intentionally and progressively made it more difficult for student loan obligations to be discharged in bankruptcy cases." *In re Douglass*, 237 B.R. 652, 653 (Bankr. N.D. Ohio 1999). In 1990, Congress extended the five-year requirement to seven years. Federal Debt Collection Procedures Act of 1990, Pub. L. No. 101-647, § 3621(2), 104 Stat. 4965; 11 U.S.C. 523(a)(8)(A) (1994). Subsequently, the statutory provision allowing discharge for loans that had been in repayment for more than seven years was eliminated in the Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971, 112 Stat. 1837, for bankruptcies filed after October 7, 1998.

All of the circuits that have addressed the issue of "undue hardship"—with the exception of the Eighth Circuit—have adopted the so-called "*Brunner*" test. See *Brunner* v. *New York State Higher Educ. Servs.*

Corp., 831 F.2d 395 (2d Cir. 1987) (per curiam). Under the *Brunner* test, a debtor claiming "undue hardship" must show:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.

Brunner, 831 F.2d at 396.

Three years ago, the Eighth Circuit rejected the *Brunner* test in favor of a totality-of-circumstances test. *In re Long*, 322 F.3d 549, 554 (2003). The court stated:

> In evaluating the totality-of-the-circumstances, our bankruptcy reviewing courts should consider: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the debtor's and her dependent's reasonable necessary living expenses; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.

Ibid. In the same paragraph, immediately after announcing this test, the court summarized it as an economic test rooted in ability to repay the debt:

> *Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal standard of living—then the debt should not be discharged.* Certainly, this determination will require a special consideration of the debtor's

> present employment and financial situation—including assets, expenses, and earnings—along with the prospect of future changes—positive or adverse—in the debtor's financial position.

Id. at 554-55 (emphasis added).

2. a. The debtor, Laura Susan Reynolds, is a graduate of Claremont McKenna College and the University of Michigan Law School. She was admitted to practice law in Colorado, but eventually settled in Minnesota, where she took temporary jobs as a secretary and then held a variety of non-legal jobs. Pet. App. 3a-4a. At the time of the bankruptcy proceedings, she was a secretary-receptionist making about $30,000 a year. At the same time, the debtor's husband was a bus driver earning about $29,000, paid over the nine months of the school year. *Id.* at 4a, 49a.

b. The debtor filed a Chapter 7 petition and brought an adversary proceeding to discharge her educational debt under the "undue hardship" exception to non-dischargeability. Pet. App. 43a. On January 2, 2004, the bankruptcy court issued an order granting her a discharge. The bankruptcy court found that the debtor had been diagnosed with "major depression, panic and anxiety disorder, borderline personality disorder, or all three" by "a half-dozen different mental health professionals." *Id.* at 49a. The bankruptcy court found that the debtor had no prospect of gaining admission to the Minnesota bar in the foreseeable future and was unable to be employed as a practicing attorney. *Id.* at 53a-54a.

The court determined that the debtor, though unable to become an attorney, had $2600 a month in household expenses and $3300 in net household income, resulting in $700 a month in available income. Pet. App. 58a; see *id.* at 55a-58a. The debtor's educational loan indebted-

ness was approximately $142,000. Paying those loans over 20 years would cost her $1021.55 a month.[1] She made payments on the loans for about six months and then stopped. *Id.* at 59a-60a.

Based on those findings of fact, the bankruptcy court recognized that the debtor "did not establish, as a matter of fact, that she lacked all means to pay down all of the component loans in her educational debt structure." Pet. App. 63a. Nevertheless, the court held that, under *In re Long*'s totality-of-circumstances test, a court must be allowed to consider the "non-pecuniary effects of a debtor's very substantial loan burden." *Id.* at 64a. The court explained that, in evaluating "undue hardship," it could and perhaps must give those non-pecuniary effects more weight than ability to pay—at least when "an educational-loan balance is very substantial in relation to a debtor's net worth and annual gross income, where the standard and restructured amortizations would extend over a very long period, *and* where the presence and awareness of that great and ongoing liability have a demonstrated, detrimental impact on the debtor's physical or mental health." *Id.* at 65a. Although the debtor's expert did not testify that relieving the debtor of the loan burden would significantly reduce her stress, the court found an "utterly clear" inference that discharge of the loan "would take a very significant stressor out of the Debtor's life and consciousness." *Id.* at 66a. Thus, the bankruptcy court concluded that under the totality of circumstances, the debtor's hardship, absent discharge,

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[1] Two lenders have not appealed to the court of appeals, and the debtor is no longer responsible for those debts. Pet. App. 10a. The remaining debt can be paid off under various scenarios with monthly payments of less than $700. *Id.* at 59a-60a.

would be undue: "Her fairly tenuous grasp on these reduced expectations [in her life] could fail, were the stressor of continuing liability on her educational loan burden, or even a portion of it, to continue. This danger is what makes the hardship of a continuing exception from discharge 'undue.'" *Id.* at 67a.

c. The district court, believing there was an "ambiguity in *Long* about how non-pecuniary factors interact with pecuniary concerns," affirmed the decision of the bankruptcy court. Pet. App. 37a-38a. It concluded that "subjugating Reynolds's severe mental illness to purely financial considerations undermines *Long*'s adherence to a 'less restrictive approach to the "undue hardship" inquiry' as compared to the more rigid *Brunner* test." *Id.* at 38a.

3. a. The United States Department of Education, Educational Credit Management Corporation, and Pennsylvania Higher Education Assistance Agency appealed to the Eighth Circuit, which affirmed in a split decision. Pet. App. 1a-27a. The three lenders argued that the totality-of-circumstances test prohibited discharge once the bankruptcy court found that the debtor could in fact repay a portion of her student-loan debt. See *In re Long*, 322 F.3d at 554-555 (emphasis added) ("Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal standard of living—then *the debt should not be discharged.*"). But according to the panel majority, "the creditors read this language too narrowly," because of "the possibility—and in many cases reality—that a debtor's health and financial position are inextricably intertwined." Pet. App. 13a.

The Eighth Circuit had previously held that a debtor's medical condition was relevant to "undue hardship" only to the extent it affected the ability to repay. *In re Andrews*, 661 F.2d 702 (8th Cir. 1981). The panel majority read *In re Andrews* to support the proposition that discharge may be appropriate even if the debtor can repay a portion of the student-loan debt, if the existence of the debt could cause stress affecting the debtor's mental health:

> As recognized in *Andrews*, illness often affects both a debtor's ability to earn and her expenses; in such cases, factors affecting the debtor's health also have a financial significance. *Where the evidence shows that financial obligations are likely to undermine a debtor's health, which in turn will affect the debtor's financial outlook, we think it entirely consistent with Andrews and Long to take such facts and circumstances into account.* We will not adopt an interpretation of "undue hardship" that causes the courts to shut their eyes to factors that may lead to disaster, both personal and financial, for a suffering debtor.

Pet. App. 14a (emphasis added). The majority emphasized the bankruptcy court's finding that continuing liability for the debt could possibly affect Reynolds's mental condition, *ibid.*, and it quoted *In re Long* for its "consideration of 'reasonably reliable future financial resources . . . and any other relevant facts and circumstances surrounding each . . . case,'" including "the prospect of future changes—positive or adverse—in debtor's financial position." *Id.* at 15a (quoting *In re Long*, 322 F.3d at 554-555). Because Reynolds's condition had been diagnosed as "recurrent," *ibid.*, the

majority concluded that the stress of repaying the debt could possibly affect her mental condition, which in turn could affect her ability to repay in the future. *Ibid.* The majority concluded that "excepting the student loans from discharge would cause an undue hardship to Reynolds because of the effect of the debt on Reynolds's mental health." *Id.* at 16a.

b. Judge Riley, in dissent, explained that the majority had misunderstood the relevance of a debtor's medical condition to the totality of circumstances. Pet. App. 20a-24a. Her mental illness might make simply being in debt stressful, but under the Bankruptcy Code, this would not constitute "undue hardship." Alternatively, her mental illness might reduce her future financial resources and possibly increase her expenses, resulting in "undue hardship." But, Judge Riley explained, such a possibility was foreclosed in this case by the bankruptcy court's findings of fact. *Id.* at 20a-21a.

Judge Riley stated that the majority had engaged in analysis that "borders on illogical circularity" by first looking to the effect of the debt on the debtor's mental condition and then looking to the effect of the thus-affected mental condition on the debtor's ability to repay the debt. Pet. App. 22a ("The majority opinion makes this very mistake: it concludes having an unpaid debt contributes to Reynolds's mental illness, and mental illness contributes to the inability to repay the debt (which inability, of course, worsens the mental illness, and so on)."). He characterized the majority's holding as "grant[ing] double treatment to a debtor's illness" and as "chang[ing] this circuit's law." *Ibid.*

Judge Riley also pointed out that the majority had ignored the bankruptcy court record, which showed that Reynolds could maintain an administrative job despite

her mental illness—a job that paid her enough, along with her husband's income, to repay her debt to the three remaining creditors. Pet. App. 22a-23a.

c. Petitioner and the United States Department of Education filed petitions for rehearing and rehearing en banc, which the court of appeals denied over five dissenting votes. Pet. App. 79a-80a.

ARGUMENT

The decision of the court of appeals is incorrect to the extent it permits discharge, on the ground of undue hardship, when the debtor has not demonstrated an inability to repay the debt. In the context of a bankruptcy proceeding, the statutory requirement of "undue hardship" necessarily entails an economic determination, and a debtor's medical condition may be relevant to undue hardship only insofar as it affects the ability to pay.

In this case, however, the decision of the court of appeals was predicated in large part on a mistaken reading of the factual record set forth in the bankruptcy court's decision. The panel majority appeared to accept the bankruptcy court's conclusion that the stress that the debtor might suffer from having to repay her student loans could be "undue hardship" because it might affect her medical condition. But the majority went beyond that conclusion to suggest, contrary to the factual record, that the debtor's worsened medical condition was likely to affect her ability to repay the debt.

Because the decision of the court of appeals thus turns upon the factual record below, this case is not a good vehicle for resolving the important legal question otherwise presented here.

1. Three years ago, in *In re Long*, the Eighth Circuit adopted a totality-of-circumstances test for undue hardship and expressly declined to adopt the *Brunner* test adopted by all other circuits that had announced a test.[2] However, like those other circuits, the Eighth Circuit made clear that its test was a purely *economic* test:

> Simply put, if the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt—while still allowing for a minimal standard of living—then the debt should not be discharged. Certainly, this determination will require a special consideration of the debtor's present employment and financial situation—including assets, expenses, and earnings—along with the prospect of future changes—positive or adverse—in the debtor's financial position.

In re Long, 322 F.3d at 554-555. It was in this economic context that the Eighth Circuit's totality-of-circumstances test invoked flexibility by allowing a court to consider "any other relevant facts and circumstances surrounding each particular bankruptcy case." *Id.* at 554.

Given the economic focus of the totality-of-circumstances test, it was unclear after *In re Long* was decided whether the test differed in a legally significant way

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[2] Currently, nine other circuits have adopted the *Brunner* test. See *Brunner* v. *New York State Higher Educ. Servs. Corp.*, *supra* (2d Cir.); *In re Brightful*, 267 F.3d 324 (3d Cir. 2001); *In re Ekenasi*, 325 F.3d 541 (4th Cir. 2003); *In re Gerhardt*, 348 F.3d 89 (5th Cir. 2003); *In re Oyler*, 397 F.3d 382 (6th Cir. 2005); *In re Roberson*, 999 F.2d 1132 (7th Cir. 1993); *In re Rifino*, 245 F.3d 1083 (9th Cir. 2001); *Educational Credit Mgmt. Corp.* v. *Polleys*, 356 F.3d 1302 (10th Cir. 2004); *In re Cox*, 338 F.3d 1238 (11th Cir. 2003), cert. denied, 541 U.S. 991 (2004).

from the *Brunner* test, which also had a purely economic focus.

2. In the bankruptcy court decision below, however, the totality test of *In re Long* was interpreted to permit consideration of non-economic factors that did not relate to the debtor's ability to repay. Although the bankruptcy court expressly held that the debtor "did not establish, as a matter of fact, that she lacked all means to pay down all of the component loans in her educational debt structure," it also announced that courts should consider the "non-pecuniary effects of a debtor's very substantial loan burden." Pet. App. 64a-65a. In particular, the bankruptcy court found an "utterly clear" inference that discharge of the loan "would take a very significant stressor out of the Debtor's life and consciousness," despite the failure of the debtor's expert to testify to that effect. *Id.* at 66a; see *id.* at 67a ("Her fairly tenuous grasp on these reduced expectations [in her life] could fail, were the stressor of continuing liability on her educational loan burden, or *even a portion of it*, to continue.") (emphasis added).

As the case reached the court of appeals, the record included a finding of fact that the debtor had *not* shown an inability to repay all of the component loans of her student debt, Pet. App. 63a, and a finding of fact that the debtor could maintain her non-lawyer employment at comparable compensation levels "for the indefinite future," *id.* at 55a. The case also presented the bankruptcy court's legal conclusion that the mere stress of having to repay student loan debt could justify a discharge of all of that debt, notwithstanding the debtor's ability to repay a portion of it. The bankruptcy court's reasoning was thus irreconcilable with the *Brunner* test,

which compels rejections of an "undue hardship" claim when the debtor has the ability to repay some or all of the debt.

The court of appeals affirmed, but it did so in a manner that makes it difficult to determine whether, and to what extent, its holding conflicts with the approach followed by the circuits that adhere to the *Brunner* test. In its conclusion to the "undue hardship" analysis, the court of appeals stated that it was affirming the bankruptcy court's conclusion that "excepting the student loans from the discharge would cause an undue hardship * * * *because of the effect of the debt on [respondent's] mental health.*" Pet App. 16a (emphasis added). At other points in its discussion, however, the court of appeals appeared to rest its decision on its view that in this case the debtor's stress was likely to affect her financial condition. *Id.* at 14a ("Where the evidence shows that financial obligations are likely to undermine a debtor's health, *which in turn will affect the debtor's financial outlook*, we think it entirely consistent with *Andrews* and *Long* to take such facts and circumstances into account.") (emphasis added).

The decision of the court of appeals therefore can be read to stand for the limited proposition that a debtor may obtain a discharge if he or she proves that the stress of repayment "will affect the debtor's financial outlook." Pet. App. 14a. Read in that fashion, the decision would still require a debtor to show that his or her financial outlook makes repayment an undue hardship. Although it is unclear that the decision will be limited to that category of cases in the future, the ambiguity in the court of appeals' holding makes the case an unappealing candidate for resolving a circuit

split that may not actually lead to a materially different result in concrete cases. It would therefore be appropriate to await a future case in which the rule of law applied by the Eighth Circuit can be clarified and the existence, or lack thereof, of a meaningful circuit conflict can be ascertained.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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